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SUBJECT: BOI Reduces Interest by 0.2% in March

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Summary

1. (U) On March 29, the Bank of Israel announced a 0.2 percent reduction in interest rates. This brings the Bank of Israel interest rate to 4.1 percent and represents the thirteenth consecutive interest rate decline since the end of March, 2003. In the press release accompanying its latest rate decision, the BOI indicated that its current monetary policy would continue as long as inflation is consistent with its inflation target of 1 - 3 percent. Although Histadrut leader Amir Peretz criticized the cut as too small, most commentators praised it as economically helpful. End Summary.

Surprise: Klein Cuts and Hints May Keep Cutting

2. (U) Prior to the latest interest rate announcement, a number of economists and market analysts predicted the BOI would call a halt to its monthly rate cuts. They noted the rate had already neared 4 percent, and claimed that during 2004 the US and Israel were likely to begin raising interest rates. In a fairly surprising turn of events, the BOI decided to continue cutting, if just by 0.2 percent. The Bank, in its March 29 press release, justified the move by noting that its interest rate policy is geared towards bringing inflation in line with the range of price stability, 1 - 3 percent a year. It noted that inflation expectations were still below the lower limit of the target, at around 1.2 percent.

BOI Boo Boo: It Missed Target in Both 2002 and 2003

3. (U) In its 2003 annual report, published March 30, the BOI acknowledged years of criticism for having consistently missed its inflation target in 2002 and 2003. The report attempts to deflect this criticism, however, by referring to numerous exogenous factors that made the target ever more elusive: sudden changes in exchange rates, the development in Israel of an inflationary mentality, receipt of the U.S. Loan Guarantees, the rapid end to the War in Iraq. The BOI notes that the policy backdrop in 2003, when the GOI embarked on a serious program of economic reform, was completely contrary to that in 2002, which was marked by uncertainty, increased inflation, and a return to higher interest rates.

Amir Peretz Kicks a Gift Horse in the Teeth?

4. (U) Commentary on the BOI cut was, for the most part, muted. Histadrut leader Amir Peretz however, denounced it as "too little too late," and said households continue to be harmed by high rates. He told Haaretz in the March 30 edition that a reduction in interest should have been part of an overall joint economic plan between the Histadrut, the GOI and employers intended to accelerate growth and increase the number of jobs.

5. (U) Others were significantly more positive in their remarks. Chairman of the Economic Committee of the Manufacturers Association, Rimon Ben Shaul, told Haaretz in the same March 30 article that the BOI acted correctly in continuing to reduce interest and should continue to do so in the coming months. Shaul noted "this would help in strengthening the recovery trend." He added that a "necessary condition for continuing to reduce interest rates is strictness in maintaining the budget and deficit target."

BOI: 4 Percent Deficit in 2004 "Attainable"

6. (U) The BOI noted in its press release that "assessments

of the development of fiscal policy over the year suggest that the budget target set by the government at 4 percent of GDP is attainable." This is a far cry from BOI's past criticism of GOI laxness regarding fiscal responsibility, and testament to the newfound BoI-MoF policy consensus on fiscal issues.

Kurtzer